

**PUBLIC UTILITIES COMMISSION**505 VAN NESS AVENUE
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Ratesetting**TO PARTIES OF RECORD IN APPLICATION 17-03-019:**

This is the proposed decision of Administrative Law Judge Debbie Chiv. Until and unless the Commission hears the item and votes to approve it, the proposed decision has no legal effect. This item may be heard, at the earliest, at the Commission's September 27, 2018 Business Meeting. To confirm when the item will be heard, please see the Business Meeting agenda, which is posted on the Commission's website 10 days before each Business Meeting.

Parties of record may file comments on the proposed decision as provided in Rule 14.3 of the Commission's Rules of Practice and Procedure.

The Commission may hold a Ratesetting Deliberative Meeting to consider this item in closed session in advance of the Business Meeting at which the item will be heard. In such event, notice of the Ratesetting Deliberative Meeting will appear in the Daily Calendar, which is posted on the Commission's website. If a Ratesetting Deliberative Meeting is scheduled, *ex parte* communications are prohibited pursuant to Rule 8.3(c)(4)(B).

/s/ ANNE E. SIMON

Anne E. Simon

Chief Administrative Law Judge

AES:avs

Attachment

Decision **PROPOSED DECISION OF ALJ CHIV (MAILED 8/27/2018)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of San Diego Gas & Electric
Company (U920E) for Waiver of Certain
Affiliate Transaction Rules for Interactions
with Unregulated Subsidiary.

Application 17-03-019

**DECISION GRANTING APPLICATION OF SAN DIEGO GAS & ELECTRIC
COMPANY (U902E) FOR WAIVER OF CERTAIN AFFILIATE TRANSACTION RULES
FOR INTERACTIONS WITH UNREGULATED SUBSIDIARY**

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DECISION GRANTING APPLICATION OF SAN DIEGO GAS & ELECTRIC COMPANY (U902E) FOR WAIVER OF CERTAIN AFFILIATE TRANSACTION RULES FOR INTERACTIONS WITH UNREGULATED SUBSIDIARY**Summary**

In this decision, we approve with conditions the application of San Diego Gas & Electric Company (SDG&E) for a waiver of certain Affiliate Transaction Rules set forth in Decision 06-12-029. SDG&E proposes to create a new unregulated subsidiary, called NewCo Sub, in order to help commercialize innovations, especially intellectual property (IP) and related products. NewCo Sub's primary activities will include managing business development efforts, commercializing IP and patents, and marketing and distributing IP products. SDG&E states that its proposed subsidiary will financially benefit ratepayers by providing an additional means by which SDG&E's IP can be commercialized.

The Commission approves SDG&E's application and grants waivers from certain of the Affiliate Transaction Rules, although more limited in scope than those requested by SDG&E.

1. Background and Procedural History

The Affiliate Transaction Rules (ATRs), as initially adopted in Decision (D.) 97-12-088 and as set forth in D.06-12-029, were intended to establish standards of conduct for relationships between Commission-regulated gas and electric utilities and their corporate affiliates. The Commission deemed these rules necessary because "the development of competitive markets would be undermined if the utility were able to leverage its market power into the related markets in which their affiliates compete."¹ The adopted rules create standards

¹ D.97-12-088 (December 16, 1997), 77 CPUC2d 422, 449, as amended by D.98-08-035 (August 6, 1998), 81 CPUC2d 607 and D.98-12-075 (December 17, 1998), 84 CPUC2d 155.

for nondiscrimination, disclosure and information, and separation aimed at fostering competition and protecting consumers' interests. The rules generally require more separation between a utility and its affiliate as "[t]he fewer transactions between the utility and its affiliate, the greater confidence we have that the affiliate lacks market power."² The Commission adopted further revisions to the ATRs in D.06-12-029.

On March 30, 2017, San Diego Gas & Electric Company (SDG&E) filed an application requesting that the Commission waive certain ATRs to allow the utility to conduct transactions with an unregulated subsidiary. SDG&E intends to create a new unregulated subsidiary (called "NewCo Sub" for purposes of this application) to help it commercialize innovations, especially intellectual property (IP) and related products that can be used by utilities and the broader energy industry in California and potentially elsewhere.

The application was protested by the Office of Ratepayer Advocates (ORA), the Utility Consumers' Action Network (UCAN), and The Utility Reform Network (TURN). A Prehearing Conference (PHC) was held on July 28, 2017 to determine parties, scope, schedule and other procedural matters. On March 13 – 14, 2018, evidentiary hearings were held.

On June 15, 2018, the Assigned Commissioner issued a ruling seeking comments on proposed modifications to SDG&E's application (Assigned Commissioner's Ruling). Comments were filed by SDG&E, TURN, and ORA on June 25, 2018, with reply comments filed by TURN and ORA on July 2, 2018. The Commission granted UCAN's motion to accept late-filed comments on July 20, 2018. This proceeding was submitted on July 20, 2018.

² *Id.*, 77 CPUC2d at 450.

2. Summary of the Application

As a utility, SDG&E states that it “is uniquely positioned to create IP products designed for the niche market of energy utilities and their customers” and uses such intellectual property as part of its operations through SDG&E Tariff Rule 2. (SDG&E’s Opening Brief at 3-4.) SDG&E seeks to commercialize this IP and related products for the benefit of other utilities and utility customers. SDG&E asserts that it has been unsuccessful in commercializing its IP to date because doing so is not one of the utility’s core competencies. Additionally, commercializing IP to third parties may unknowingly expose SDG&E and its ratepayers to additional liabilities. (*Id.* at 5.)

For these reasons, SDG&E proposes to create NewCo Sub to help it commercialize innovations, especially IP and related products. SDG&E seeks to commercialize its IP through either (1) the sale or license of its IP to NewCo Sub, who may further commercialize the IP as it deems appropriate, or (2) the sale or license of its IP to a third party. (SDG&E’s Opening Brief at 32.) If SDG&E considers NewCo Sub for a potential transaction, SDG&E will retain an Independent Evaluator to monitor SDG&E’s activities and decisions. Compensation received by SDG&E from NewCo Sub or a third party for a particular IP transaction, whether by annual fee, royalty on net sales revenue, or one-time sale, will be distributed 75 percent to ratepayers, 25 percent to shareholders. (*Id.*)

NewCo Sub will be a separate corporate entity from SDG&E and will be subject to the Affiliate Transaction Rules, except for the waivers requested in this application. NewCo Sub’s primary activities will include managing business development efforts, commercializing IP and patents, and marketing and distributing IP products. SDG&E states that the proposal will financially benefit

ratepayers “by providing another avenue through which SDG&E-owned IP can be commercialized....” (SDG&E’s Opening Brief at 7.)

SDG&E does not need Commission approval to form NewCo Sub. However, SDG&E requires Commission approval for the requested waivers of certain Affiliate Transaction Rules. SDG&E also seeks Commission approval for the proposed sharing mechanism for revenue generated from the transfer of intellectual property from SDG&E to NewCo Sub or a third party. Finally, SDG&E seeks approval to use a standardized framework for future IP transactions that require approval under Public Utilities Code Section 851 in order to expedite the Commission’s review of those transactions.

3. Discussion

SDG&E has the burden to demonstrate that circumstances warrant a waiver of the ATRs. We have considered SDG&E’s application, as well as SDG&E and opposing parties’ responses, testimony and briefs. Based on this review, we conclude that SDG&E has met its burden of proof with respect to certain requests. In considering the ratepayer benefits that may be derived from commercialization of SDG&E’s IP, and subject to the conditions adopted in this decision, we conclude that SDG&E’s request for waivers is reasonable, with the exception of Rule V.G.1 as discussed below. We find that approval of the waivers is reasonable to facilitate the financial benefits ratepayers may receive from the commercialization of SDG&E’s IP. However, we also find it necessary to modify the requested waivers in several respects to promote the development of competitive markets and avoid adverse risks to ratepayers.

As the basis for our conclusion, we summarize each ATR for which SDG&E seeks a waiver, noting the claimed concerns with each rule. We consider

whether the requested waiver provides a suitable remedy and/or raises other issues, and where appropriate, require additional conditions.

3.1. Category 1 – Rules Governing the Sharing of Information

Under the first category, SDG&E requests waivers to three affiliate transaction rules that restrict the disclosure of a utility's proprietary and confidential information to an affiliate. Rule III.B.2 states, in pertinent part, that "[i]f a utility provides supply, capacity, services, or information to its affiliate(s), it shall contemporaneously make the offering available to all similarly situated market participants, which include all competitors serving the same market as the utility's affiliate." Rule III.E.4 prohibits a utility from sharing market analysis reports, and other non-publicly available reports, with its affiliates. Rule IV.B provides: a utility shall "make non-customer specific non-public information, including but not limited to information about a utility's natural gas or electricity purchases, sales or operations or about the utility's gas-related goods or services and electricity-related goods or services, available to the utility's affiliates only if the utility makes that information contemporaneously available to all other service providers on the same terms and conditions, and keeps the information open to public inspection."

SDG&E states that these rules are applicable when the utility solicits interest from or negotiates with third parties and NewCo Sub. If SDG&E wants to solicit interest from NewCo Sub for a potential transaction, waivers are necessary because otherwise (a) SDG&E cannot exchange strategic or market-based information with NewCo Sub, even with a Non-Disclosure Agreement (NDA) in place, and (b) covered information that SDG&E discloses to NewCo Sub must then be disclosed to all "similarly situated market participants," "other service providers," and/or the information must be "open to public inspection."

(SDG&E's Opening Brief at 15-17.) Without the waivers, SDG&E asserts that it is unlikely to pursue an IP contract with NewCo Sub since the affiliate would be restricted from obtaining relevant information that other potential bidders would have, thereby making it unlikely that the affiliate would offer a bid. Moreover, without a waiver, SDG&E would be dissuaded from disclosing proprietary information to NewCo Sub because the information would then have to be publicly posted. This would effectively undermine the value of the IP. (*Id.*)

As part of its requested waivers, SDG&E states that NewCo Sub will still be subject to an NDA, as will all potential bidders, before receiving any proprietary or confidential information. The intervenors, namely TURN, express concern that even with an NDA in place, NewCo Sub could be granted access to proprietary or confidential information that third party bidders may not have, giving the affiliate an unfair advantage over other bidders. (TURN's Closing Brief at 9.)

The Commission recognizes that the restrictions imposed by the three ATRs will likely disincentivize SDG&E from pursuing the contemplated IP transactions with NewCo Sub. However, the Commission shares TURN's concern that even with an NDA in place, NewCo Sub and other bidders should have access to the same information, under the same material terms and conditions. Subject to the condition that NewCo Sub and third party bidders are treated equally for purposes of the NDA, the Commission finds the requested waivers to be reasonable, as the waivers would not provide a competitive advantage to the affiliate by means of sharing information.

For these reasons, the Commission approves the waivers of Rules III.B.2, III.E.4, and IV.B subject to the following condition: any information disclosed to NewCo Sub by SDG&E that would have been covered by the ATRs in this

category shall (1) be subject to a Non-Disclosure Agreement under the same material terms and conditions as NDAs governing potential third party bidders, (2) be limited to the same information provided to potential third party bidders and only be related to the IP offered; and (3) be provided to third parties and NewCo Sub with adequate time for review in advance of a deadline to submit a bid.

3.2. Category II – Rules Governing the Transfer Price of IP

Under the second category, SDG&E requests waivers to ATRs that generally require that sales transactions between a utility and an affiliate arise out of an open competitive bidding process and are priced at fair market value. Rule III.B provides, in pertinent part, that transactions between a utility and affiliate “shall be limited to tariffed products and services, to the sale of goods, property, products or services made generally available by the utility or affiliate to all market participants through an open, competitive bidding process...” Rule V.H.1 provides that “[t]ransfers from the utility to its affiliates of goods and services produced, purchased or developed for sale on the open market by the utility will be priced at fair market value.”

SDG&E seeks a waiver of Rule III.B because it asserts that with regard to IP transactions, the process of soliciting interest from third parties is much narrower and more targeted than an open competitive bidding process used for power purchase agreements. For these solicitations, SDG&E typically identifies third parties based on interest and unique ability to commercialize a certain product. Requiring an open competitive bidding process available to all market participants for each IP transaction, SDG&E claims, would not result in a better

final contract and would discourage the utility from considering NewCo Sub as a potential bidder. (SDG&E's Opening Brief at 19.)

SDG&E also seeks a waiver of Rule V.H.1 because it asserts that for IP licensing negotiations, an open competitive bidding process is not the only or best way to determine "fair market value." SDG&E states that when it evaluates contractual partners and offers, it considers a variety of factors other than the offered price, including the financial stability of the party, the length of the contract, the party's industry knowledge and experience, etc. (*Id.* at 20.) As part of its requested waivers, SDG&E proposes to retain an Independent Evaluator for any transaction in which NewCo Sub is a potential contractual partner. The Independent Evaluator will observe whether SDG&E's activities and decisions were fair and reasonable throughout the negotiation and selection process. (*Id.*)

TURN argues that without an open, competitive bidding process, SDG&E can selectively limit the number of parties from whom it solicits interest, potentially giving NewCo Sub an unfair advantage if it is the only bidder. If NewCo Sub is the only bidder, the affiliate can potentially acquire the IP at an artificially low price. (TURN's Closing Brief at 6.) TURN and UCAN also comment that an Independent Evaluator has no practical way to assess a transaction's fair market value if NewCo Sub is the only bidder. (UCAN's Opening Brief at 16; TURN's Closing Brief at 15-16.) The resulting effect is the Commission has no assurances as to the value of a transaction, fair or otherwise.

The Commission recognizes that an open competitive bidding process may not be the optimal way of soliciting interest for IP products and that requiring compliance with these ATRs will likely discourage SDG&E from considering NewCo Sub as a potential contractual partner. However, the Commission agrees

with the intervenors that SDG&E should not unilaterally limit the number of bidders such that NewCo Sub could be the only bidder. Further, the Commission agrees that in the event that NewCo Sub is the only bidder, it will be difficult for an Independent Evaluator to assess the transaction's fair market value.

In comments to the Assigned Commissioner's Ruling, SDG&E voluntarily agrees that for each IP transaction in which it solicits interest from NewCo Sub, the utility will provide an open solicitation offer on its website (e.g., www.sdge.com/sdge-solicitation-request-offer-proposal-distribution-list) and provide notices to entities that register to receive such notices. (SDG&E's Comments to Assigned Commissioner's Ruling at 4.) The open solicitation offer will describe the IP in non-confidential terms and interested parties may request additional information, potentially subject to an NDA. This condition addresses SDG&E's concerns about the sharing of non-public information and the open competitive bidding process, while giving a broader set of third parties an opportunity to inquire about a particular transaction.

To that end, the Commission grants the waiver of Rule III.B with the following condition: for any IP in which SDG&E solicits interest from NewCo Sub, SDG&E shall provide an open solicitation offer on its website describing the IP in non-confidential terms and also provide notices to parties registered to receive such notices. Any interested party may respond to obtain further information, potentially subject to an NDA.

In granting the waiver of Rule III.B with the open solicitation offer condition, the Commission also recognizes that it may be difficult to ascertain the fair market value of the IP products being offered for contract. Given that a broader set of parties will have an opportunity to potentially bid on a

transaction, we believe the ultimate transaction price should more accurately reflect the appropriate value for the IP. However, the Commission notes that the Independent Evaluator is in the best position to assess the reasonableness of the transaction value and should provide such an evaluation.

To that end, the Commission grants the waiver of Rule V.H.1 subject to the following condition. Rather than require the Independent Evaluator to assess whether a price is the fair market value, the Evaluator shall instead specifically evaluate whether the transaction price for the selected offer reflects the best value for ratepayers. The assessment is not dispositive as to the approval of any Section 851 filing but will be one factor considered by the Commission.

3.3. Category III - Rules Governing Shared Officers and Directors

SDG&E requests a waiver of Rule V.G.1 which, in pertinent part, provides that a utility and its affiliate shall not jointly employ the same employees, including corporate officers and board of directors. SDG&E states that this waiver is necessary because NewCo Sub will be funded solely by SDG&E shareholders and SDG&E shareholders have an interest in at least some level of governance of the subsidiary's board, including "some members who are representing the investment of the main investors." (SDG&E's Opening Brief at 21.) SDG&E states that without shared officers and board members, SDG&E's shareholders will be disincentivized from investing in NewCo Sub at all. (*Id.* at 22.)

Even if the waiver is granted, SDG&E offers to continue to maintain current anti-conduit compliance and procedures to ensure that shared officers and directors are not acting as informational conduits. (*Id.* at 22.) SDG&E will voluntarily comply with the reporting aspects of Rule V.G.1, including requiring a corporate officer to verify the adequacy of the anti-conduit procedures in place

as part of the utility's Annual Compliance Plan and requiring a notification to the Commission of the names of all shared officers and directors.

TURN takes issue with this waiver, asserting that NewCo Sub could obtain informational advantages over other third parties. For example, NewCo Sub may receive advance knowledge that SDG&E plans to solicit bids, which may give the affiliate additional time for diligence. (TURN's Closing Brief at 10.) Also, a shared employee who was involved in the development or commercialization efforts of particular IP while at SDG&E may have inside knowledge over third parties that may advantage NewCo Sub in the bidding process.

The Commission agrees that TURN's arguments have merit and finds that a blanket waiver of the restrictions on shared officers and directors is not appropriate. Nevertheless, the Commission recognizes that SDG&E shareholders who propose to invest in NewCo Sub may be disincentivized from investing if they are allowed no direct oversight in their investment. As to shared directors, the Commission finds that SDG&E's rationale that shareholders be granted some level of oversight in their investment is reasonable.

For these reasons, the Commission grants a limited waiver of Rule V.G.1 as applied only to shared directors, subject to the following conditions: (1) no more than 40 percent of NewCo Sub's Board of Directors shall be comprised of shared directors, and (2) the Commission maintains discretion to reevaluate this waiver no earlier than two (2) years following the issuance of this decision.

SDG&E shall still comply with the reporting requirements of Rule V.G.1, including requiring a corporate officer to describe and verify the adequacy of the anti-conduit procedures in place as part of the utility's Annual Compliance Plan and requiring notification to the Commission of the names of all shared officers

and directors. (SDG&E's Opening Brief at 22.) In addition, as proposed by SDG&E, SDG&E shall implement firewall safeguards applicable to any shared directors such that, for example, shared directors are walled off from access to information during "negotiations and other commercially sensitive" time periods, are not involved in the "evaluation" of IP, and are not engaged in "day-to-day operations or operational decisions of the NewCo Sub." (*Id.* at 10, 22.)

While we find that SDG&E shareholder oversight is reasonable at the director-level, it is unclear from the record why NewCo Sub requires shared officers as well. By SDG&E's own assertions, shared officers and directors will not be involved in day-to-day operations of NewCo Sub or have access to information during commercially sensitive time periods. Given that a shared officer will not be involved in evaluation of decision-making related to particular IP, the Commission finds no compelling reason why SDG&E requires shared officers, in addition to shared directors, to oversee shareholders' investment in NewCo Sub. For these reasons, the Commission concludes that SDG&E has not met its burden in establishing why the circumstances warrant shared officers, in addition to shared directors, and therefore, a waiver of Rule V.G.1 as applied to shared officers is denied.

3.4. Standardized Sharing Mechanism

SDG&E proposes a standardized sharing mechanism for revenue received by SDG&E from NewCo Sub or a third party for an IP sales or licensing transaction. The proposed mechanism would distribute gross pre-tax revenue received by SDG&E as 75 percent to ratepayers and 25 percent to shareholders. This structure would be applicable whether SDG&E contracts with NewCo Sub or a third party, whether the transaction was a license or sale of the IP, and

regardless of the form of payment (whether by annual fee, royalty on net sales revenue, or one-time sale).

The intervenors, particularly ORA, are concerned that SDG&E's sharing mechanism only applies if SDG&E licenses or sells IP to NewCo Sub or a third party. Once SDG&E licenses or sells IP to NewCo Sub, however, NewCo Sub can further commercialize the IP through a third party transaction but the revenue is recovered solely by NewCo Sub's shareholders. (ORA's Opening Brief at 11.) ORA states that this structure may incentivize SDG&E to license or sell IP to NewCo Sub at an artificially low price and at a later date, NewCo Sub may commercialize the IP in a future transaction and reap greater profits for NewCo Sub's shareholders. (*Id.*)

The Commission concludes that the proposed 75 percent/25 percent sharing mechanism for SDG&E's IP transactions with NewCo Sub or a third party (called Sharing Mechanism I, for purposes of this decision) is reasonable. As for future commercialization efforts by NewCo Sub, the Commission agrees with ORA. Since ratepayers initially funded the development of SDG&E's IP, ratepayers should benefit from revenue earned for ongoing commercialization activity.

Therefore, the Commission approves the proposed Sharing Mechanism I with the following condition: in the event that NewCo Sub acquires or licenses IP from SDG&E and subsequently, sells or licenses the IP to a third party, the gross pre-tax revenue received by NewCo Sub shall be shared 75 percent to SDG&E ratepayers and 25 percent to NewCo shareholders. This distribution (called Sharing Mechanism II) shall apply regardless of the form of payment, whether by annual fee, royalty on net sales revenue, or one-time sale. The Commission finds that the adoption of Sharing Mechanisms I and II appropriately addresses

the concern that SDG&E shareholders may select NewCo Sub as a contractual partner for a below-market transaction price with the intent to recoup greater revenue from future commercialization, while allowing SDG&E ratepayers who funded the initial IP to benefit from ongoing commercialization success.

TURN raises the concern that imposing Sharing Mechanism II for subsequent transactions by NewCo Sub may chill investments by NewCo Sub who could be at a competitive disadvantage compared to third parties, who are not subject to an additional sharing mechanism. (TURN's Comments to Assigned Commissioner Ruling at 4.) However, when SDG&E submits an application pursuant to Public Utility Code Section 851 for an IP transfer between SDG&E and a non-affiliate third party, the Commission intends to review such transfers, and any corresponding benefits to ratepayers, in a similar manner as it would for a transfer between NewCo Sub and SDG&E.

3.5. Standardized Information for Section 851 Filings

Pursuant to Public Utility Code Section 851, SDG&E must submit all IP transactions between the utility and its future affiliate, NewCo Sub, to the Commission for approval. In an effort to simplify the Commission's review of these prospective filings, SDG&E proposes to standardize the Section 851 filings, as follows: (1) retain an Independent Evaluator to review the evaluation, selection, and negotiation process for IP transactions involving NewCo Sub, (2) document whether SDG&E's activities and decisions were fair, reasonable and performed with no preferential treatment, and (3) commit to the standardized sharing mechanism of 75 percent for ratepayers and 25 percent for shareholders. SDG&E further proposes that SDG&E ratepayers pay for the cost of the Independent Evaluator.

All intervenors oppose the proposal that the Independent Evaluator be paid for by ratepayers, rather than SDG&E shareholders. Since SDG&E's shareholders' desire to establish NewCo Sub created the need for an Independent Evaluator in the first instance, the intervenors state that shareholders should be directed to pay the costs before revenue from any IP transaction is distributed via the sharing mechanism. (ORA's Opening Brief at 15; UCAN's Opening Brief at 14; TURN's Closing Brief at 15.)

The Commission agrees with the intervenors as to the payment of the Independent Evaluator. In support of its proposal, SDG&E cites past Commission decisions where an Independent Evaluator was paid for by ratepayers. (SDG&E's Opening Brief at 36, citing D.14-11-042.) However, those proceedings involved electricity procurement contracts and are distinct from the present scenario of a utility-driven interest in commercializing IP for profit. Indeed, in SDG&E's comments to the Assigned Commissioner's Ruling, SDG&E voluntarily agrees that shareholders will cover the cost of the Independent Evaluator so long as the scope of the report is not expanded to evaluate the fair market value of the transaction. (SDG&E's Comments to Assigned Commissioner Ruling at 7.)

To that end, the Commission approves the proposed standardized information framework for Section 851 filings related to SDG&E's IP subject to the condition that: (1) the cost of the Independent Evaluator is covered by SDG&E shareholders, and (2) the standardized sharing mechanism is expanded to include Sharing Mechanism II, as described in Section 2.4. Nevertheless, in all cases, the Commission reserves the discretion to require SDG&E to provide further information related to a particular Section 851 application before the Commission acts on the application.

3.6. Further Conditions for Approval of the Application

In granting the specified waivers to the Affiliate Transaction Rules, the Commission adopts the following additional conditions.

3.6.1. Future Use of IP

With respect to IP that SDG&E develops, the utility's current practice is to maintain the IP for its own operational use. For SDG&E-developed IP that SDG&E then licenses to a third party, SDG&E states that "it has been SDG&E's past practice to maintain a nonexclusive license, although that is not SDG&E's official position." (SDG&E's Opening Brief at 45.)

The intervenors express concern that SDG&E's proposal does not include an explicit retention of a non-exclusive license for IP the utility sells or licenses to NewCo Sub or a third party. The concern is that if NewCo Sub or a third party acquires the IP rights from SDG&E, that party could potentially license the IP back to SDG&E at a higher cost, which seems unfair given that ratepayers funded the development of the initial IP. The Commission agrees that because ratepayers funded the IP's initial development, it is important that SDG&E retain a non-exclusive license for its continued use for the benefit of ratepayers.

In comments, SDG&E voluntarily agrees to comply with this condition, stating that SDG&E will "retain a non-exclusive license to IP with respect to products and services that SDG&E offers to its customers within its service territory." (SDG&E's Comments to Assigned Commissioner's Ruling at 8.) Therefore, the Commission adopts the condition that for any IP rights SDG&E transfers to NewCo Sub or a third party, SDG&E shall retain a non-exclusive, irrevocable, royalty-free, and cost-free perpetual license with respect to products and services SDG&E offers to its customers within its service territory.

3.6.2. Liability Limitations of Future IP Transactions

There are two types of potential liability at issue with SDG&E's proposal. The first relates to liability that may be arise from NewCo Sub as a separate entity and that may be borne by SDG&E as the parent company. The second relates to liability that may arise from a specific IP product contracted by SDG&E with either a third party or NewCo Sub.

Regarding the first type of liability, SDG&E states that one of its reasons for establishing NewCo Sub is so that NewCo Sub, as a separate legal entity, will "bear the burden of its own financial and legal risks including, but not limited to, financial losses, litigation related to NewCo Sub's products sold, and other risks that commercial ventures often face." (SDG&E's Opening Brief at 42.) As SDG&E asserts, structuring NewCo Sub as a separate entity, "complete with its own governance structure, administration and operations, would serve to contain liability at the subsidiary level." Regarding the second type of liability that may arise out of particular IP products, SDG&E states that it will negotiate liability limitations with NewCo Sub on a contract-by-contract basis, as it currently does with third party contracts.

The intervenors express concern that despite SDG&E's assertions, there is a potential for ratepayers to be responsible for liability arising out of NewCo Sub or a particular IP transaction. The intervenors recommend that the Commission direct any financial or legal loss arising out of liability from an IP transaction or NewCo Sub to be borne solely by shareholders and not ratepayers. (TURN's Closing Brief at 17; UCAN's Opening Brief at 10; ORA's Opening Brief at 7.)

The Commission agrees with the intervenors about any potential legal or financial liability. While SDG&E protests the recommendation that SDG&E shareholders accept responsibility for liability borne by SDG&E as a result of these IP transactions, the utility simultaneously asserts that the subsidiary

structure is designed to ensure SDG&E is insulated from potential liability. Beyond that, it is not reasonable to subject ratepayers to liability risks from commercial transactions that do not relate to core energy services on which their relationship with SDG&E is based. The Commission adopts the condition that any liability arising from NewCo Sub or SDG&E as a result of an IP transaction or actions taken by NewCo Sub shall be borne solely by SDG&E's shareholders, and not extend to SDG&E's ratepayers.

4. Categorization and Need for Hearing

In Resolution ALJ 176-3396, dated April 27, 2017, the Commission preliminarily categorized this proceeding as ratesetting, and preliminarily determined that hearings were necessary. The Joint Scoping Memo and Ruling of Assigned Commissioner and Administrative Law Judge (ALJ), issued on January 19, 2018, confirmed the ratesetting categorization and determined evidentiary hearings were necessary.

5. Comments on Proposed Decision

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed _____, and reply comments were filed on _____ by _____.

6. Assignment of Proceeding

Clifford R. Rechtschaffen is the assigned Commissioner and Debbie Chiv is the assigned ALJ in this proceeding.

Findings of Fact

1. The Commission adopted the ATRs, the latest version of which is set forth in D.06-12-029, to serve as standards of conduct governing relationships between California natural gas or electric utilities and their affiliates.

2. ATRs were found necessary because the development of competitive markets would be undermined if the utility were able to leverage its market power into the related markets in which its affiliates compete.

3. SDG&E seeks approval to create an unregulated subsidiary, called NewCo Sub, in order to commercialize IP and related products for the benefit of other utilities and utility customers.

4. NewCo Sub will be an affiliate subject to the ATRs because it will be an affiliated subsidiary of SDG&E.

5. In order to facilitate pursuing the contemplated IP transactions, SDG&E seeks certain waivers of the ATRs, including among other requirements, restrictions on the disclosure of proprietary information, requirements to engage in an open competitive bidding process, and limitations on shared officers and directors.

6. Under Rules III.B.2 and IV.B, a utility can provide certain confidential or proprietary information to an affiliate if it contemporaneously provides such information to similarly situated market participants, other service providers, or publicly posts that information. Under Rule III.E.4, a utility is prohibited from sharing market analysis and similar non-public reports with its affiliates.

7. Without a waiver of Rules III.B.2, III.E.4, and IV.B, SDG&E will be unable to pursue, or dissuaded from pursuing, the contemplated IP transactions with NewCo Sub due to restrictions on the disclosure of proprietary information to an affiliate.

8. Under Rules III.B and V.H.1, sales transactions between a utility and its affiliates shall arise out of an open competitive bidding process and shall be priced at fair market value, respectively.

9. Without a waiver of Rules III.B and V.H.1, SDG&E will be dissuaded from pursuing the contemplated IP transactions with NewCo Sub due to the requirements to engage in an open competitive bidding process and price transactions at fair market value.

10. SDG&E agrees that for any IP in which NewCo Sub is a potential contractual partner, it will provide an open solicitation offer on its website and provide notices to parties that register to receive such notices.

11. Rule V.G.1 provides that a utility and its affiliate cannot jointly employ the same employees, including corporate officers and board of directors.

12. Without a waiver of Rule V.G.1, it is unlikely that SDG&E shareholders will invest in NewCo Sub due to a lack of oversight in their investment.

13. As to the limitation on shared officers under Rule V.G.1, SDG&E has failed to establish why the circumstances warrant shared officers and how the proposed safeguards prevent shared officers from becoming informational conduits.

14. SDG&E's proposed sharing mechanism, distributing 75 percent to ratepayers and 25 percent to shareholders, does not include revenue distribution to ratepayers for future commercialization efforts by NewCo Sub.

15. An additional sharing mechanism in which revenue received by NewCo Sub for future commercialization of IP, distributed as 75 percent to ratepayers, 25 percent to shareholders, allows SDG&E ratepayers to benefit from any ongoing commercialization success.

16. SDG&E agrees that shareholders will cover the cost of an Independent Evaluator.

17. SDG&E agrees that for any IP agreements with NewCo Sub or a third party, SDG&E will retain a non-exclusive, irrevocable, royalty-free, and cost-free

perpetual license with respect to products and services SDG&E offers to its customers within its service territory.

18. Liability arising out of actions taken by NewCo Sub or as a result of a specific IP transaction between SDG&E and NewCo Sub should be solely borne by SDG&E shareholders and should not extend to SDG&E ratepayers.

19. The Commission has discretion to require SDG&E to provide further information related to a particular Section 851 application before the Commission acts on the application.

20. There are potential financial benefits to ratepayers from the commercialization of SDG&E's IP. The restrictions imposed by the specified ATRs would impose barriers to SDG&E's efforts to commercialize IP.

21. In order for waivers of the specified ATRs to provide a remedy that does not pose an adverse risk to ratepayers, the conditions set forth in the Ordering Paragraphs below are necessary.

Conclusions of Law

1. The Commission's Affiliate Transaction Rules are necessary to prevent the undermining of competitive markets which could be placed at risk if the utility were able to leverage its market power into the related markets in which its affiliates compete.

2. SDG&E's application should be granted on the terms set forth in the Ordering Paragraph 2 below.

3. Granting the waivers from the specified ATRs in accordance with the Ordering Paragraphs below will not compromise the protections provided to ratepayers under the existing rules.

4. The waivers from the specified ATRs granted below should be conditioned on compliance with the requirements set forth in Ordering Paragraph 3 of this

decision. These conditions are necessary to provide assurances that ratepayers are not adversely impacted and without these conditions, the waivers are not reasonable.

O R D E R

IT IS ORDERED that:

1. Application 17-03-019 is hereby granted in accordance on the terms set forth in Ordering Paragraphs 2 and 3 below, as discussed in this decision.

2. San Diego Gas & Electric Company (SDG&E) is hereby granted certain waivers of the Affiliate Transaction Rules as set forth in Decision 06-12-029, to the extent specified as follows and subject to the conditions in Ordering Paragraph 3 below:

- a. Rules III.B.2, IV.B, III.E.4, to the extent they restrict or condition information sharing between NewCo Sub and SDG&E;
- b. Rule III.B, to the extent it limits or conditions the sale of goods, products, or services that SDG&E may make available to NewCo Sub;
- c. Rule V.H.1, to the extent it applies to the pricing of goods and services between SDG&E and NewCo Sub; and
- d. Rule V.G, to the extent it restricts the sharing of directors.
This waiver does not apply to the sharing of officers.

3. The waivers from the Affiliate Transaction Rules specified in Ordering Paragraph 2 shall be effective only on the condition that San Diego Gas and Electric (SDG&E) comply with the following conditions:

- a. Information disclosed to NewCo Sub by SDG&E in furtherance of an IP transaction that would have been covered by Rules III.B.2, IV.B, and III.E.4 shall (1) be subject to a Non-Disclosure Agreement with the same material terms and conditions as NDAs governing potential third party bidders, (2) be limited to the same information provided to potential third party bidders and only be

- related to the IP offered; and (3) be provided to third parties and NewCo Sub with adequate time for review in advance of a deadline to submit a bid.
- b. For any IP transaction in which SDG&E solicits interest from NewCo Sub, SDG&E will provide an open solicitation offer on its website (e.g., www.sdge.com/sdge-solicitation-request-offer-proposal-distribution-list), describing the IP in non-confidential terms, and provide notices to entities that register to receive such notices.
 - c. For any IP transaction for which SDG&E solicits interest from NewCo Sub, an Independent Evaluator will specifically assess whether the final price of the IP transaction that was selected provides the best value for ratepayers and include that assessment in its report. This requirement is in addition to the Independent Evaluator's assessment of whether SDG&E's activities and decisions during the selection and negotiation process were fair, reasonable, and performed without preferential treatment.
 - d. SDG&E and NewCo Sub are permitted to share directors under Rule V.G.1 so long as no more than 40 percent of NewCo Sub's Board of Directors is comprised of shared directors. The Commission maintains discretion to reevaluate this condition no earlier than two (2) years following the issuance of this decision.
 - e. SDG&E shall continue to comply with the reporting requirements of Rule V.G.1, including requiring a corporate officer to verify the adequacy of the anti-conduit procedures in place as part of the utility's Annual Compliance Plan and requiring notification to the Commission of the names of all shared officers and directors.
 - f. SDG&E shall implement firewall safeguards in order to ensure that shared directors do not become informational conduits, including but not limited to, ensuring shared directors are walled off from information access during negotiations and commercially sensitive time periods, are not involved in the evaluation of IP, and are not engaged in

- the day-to-day operations or operational decisions of NewCo Sub.
- g. SDG&E shall share gross pre-tax revenue received by SDG&E from either NewCo Sub or a third party as a result of an IP transaction at 75 percent to ratepayers, 25 percent to shareholders (called Sharing Mechanism I). This distribution shall apply regardless of the form of payment, whether by annual fee, royalty on net sales revenue, or one-time sale.
 - h. In the event that NewCo Sub acquires or licenses IP from SDG&E and subsequently sells or licenses the IP to a third party, gross pre-tax revenue received by NewCo Sub shall be shared 75 percent to SDG&E ratepayers and 25 percent to NewCo Sub's shareholders. This distribution (called Sharing Mechanism II) shall apply regardless of the form of payment, whether by annual fee, royalty on net sales revenue, or one-time sale.
 - i. SDG&E shareholders shall cover the cost of the Independent Evaluator.
 - j. For any IP rights SDG&E transfers to NewCo Sub or a third party, SDG&E shall retain a non-exclusive, irrevocable, royalty-free, and cost-free perpetual license with respect to products and services SDG&E offers to its customers within its service territory.
 - k. Any liability imposed on NewCo Sub or SDG&E as a result of a specific IP transaction between NewCo Sub and SDG&E, or as a result of actions taken by NewCo Sub shall be borne solely by SDG&E's shareholders, and not extend to SDG&E's ratepayers.
 - l. The Commission shall maintain discretion to require SDG&E to provide further information related to a particular Section 851 application before the Commission acts on the application.

4. Application 17-03-019 is closed

This order is effective today.

Dated _____, at Sacramento, California.